

1 **REBUTTAL TESTIMONY**
2 **OF**
3 **JULIUS A. WRIGHT**
4 **ON BEHALF OF**
5 **SOUTH CAROLINA ELECTRIC & GAS COMPANY**
6 **DOCKET NO. 2004-178-E**

7
8
9 **I. INTRODUCTION**

10
11 **Q. ARE YOU THE SAME JULIUS A. WRIGHT WHO HAS TESTIFIED**
12 **PREVIOUSLY IN THIS PROCEEDING?**

13 **A.**Yes. I am.

14 **Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?**

15 **A.**I am rebutting a portion of the direct testimony filed by several
16 intervenor witnesses related to the recovery of the GridSouth expenses. The
17 specific intervenor witnesses that I will rebut on this issue include Mr. Ralph
18 Smith, Mr. Glenn Watkins, and Mr. Kevin O'Donnell. In this rebuttal
19 testimony I will discuss why, contrary to the testimony of these intervenors, the
20 GridSouth expenses should be fully recoverable at this time.

21
22 **Q. HOW IS THE REMAINDER OF YOUR TESTIMONY ORGANIZED?**

23 **A.**The remainder of my testimony is organized into three sections:

- 24 1. A brief overview of the history related to the nationwide

development of Regional Transmission Organizations (“RTO”) through proceedings undertaken at the Federal Energy Regulatory Commission (the “FERC”) and the Congress.

2. A brief review of the development of GridSouth and how this project was born and guided by policies adopted and prescribed by the FERC and why the Company’s costs related to these efforts, contrary to the testimony of the intervenors cited above, are fully and justifiably recoverable at this time.
3. Finally, I will comment on some specific points discussed in the intervenors testimony related to the recovery of the GridSouth costs.

II. A BRIEF OVERVIEW OF THE HISTORY RELATED TO THE DEVELOPMENT OF RTOS

Q. PLEASE GIVE THE COMMISSION A BRIEF REVIEW OF THE INITIAL PROCEEDINGS AND DEVELOPMENTS WHICH BEGAN THE MOVEMENT TOWARDS NATIONWIDE RTOS.

A. To fully understand the development of GridSouth and the FERC’s role in this issue one must understand the development of non utility-owned generating assets and the wholesale power marketplace. The current

1 movement to RTOs is part of a general movement to competition in the
2 electric industry, sometimes called electric restructuring, including
3 competition at both the retail and wholesale level (wholesale competition is
4 sometimes called “open access”). This process, while coming to fruition
5 over the past decade, took its roots in the 1970s. Up until that time, the
6 electric industry was a declining cost, declining rate industry. In the 1970s, a
7 number of circumstances led to rapidly escalating costs of electricity. These
8 factors included the 1970 Clear Air Act requiring additional emissions
9 controls on new coal plants, the first OPEC oil embargo in 1973, the Power
10 Plant and Industrial Fuel Use Act in 1978, and the nuclear accident at the
11 Three Mile Island nuclear plant in 1979.¹

12 At the same time the national economy was seeing high inflation rates
13 and high interest rates (the prime interest rate hit double digits for a period of
14 time). As a consequence of these and other events between 1970 and 1985,
15 the average price of electricity for residential customers tripled in nominal
16 terms.² Over the same period industrial electric rates more than quadrupled
17 in nominal terms.³

18 In part, as a response to these developments, electric generation

¹ The accident at Three Mile Island led to additional safety regulations for all nuclear plants, those already built and those under construction. This led to significant increases in the cost of these plants. For example, for new nuclear plants completed after 1979 the cost rose almost tenfold as compared to plants completed prior to 1971. See “Electric Utility Restructuring,” Peter Fox, Penner, Public Utility Reports Inc., Arlington, VA, 1997, pp. 14.

1 competition at the wholesale level began with the passage of the Public
2 Utility's Regulatory Policies Act (PURPA) of 1978. This act created the
3 opportunity for non-utility owned generation to be built, and this non-utility
4 owned generation began to be built around the country. Over time, and in an
5 effort to promote greater competition in the wholesale or bulk power market,
6 Congress adopted the Energy Policy Act ("EPA") of 1992. This act gave the
7 FERC expanded authority over transmission services and led to increased
8 availability of transmission access for wholesale generators.

9 **Q. PLEASE EXPLAIN THE IMPACT OF THIS ENERGY POLICY ACT**
10 **AND DEVELOPMENTS SINCE ITS PASSAGE.**

11 **A.** In many ways the passage of the EPA really began the movement toward
12 RTOs because it encouraged regulators to view a transmission system as a
13 common carrier of services. Following the EPA, the FERC seized upon the
14 idea that a more definitive open access transmission paradigm was required
15 and introduced the idea of Regional Transmission Groups ("RTGs")⁴ in a
16 policy statement. These RTGs were to provide a forum for resolving
17 transmission issues on a regional basis and thereby promote efficiency and
18 wholesale competition. However, in actual practice these groups were not
19 able to resolve many pricing disputes.⁵

² FERC Order 888, Final Rule, p. 20.

³ Ibid.

⁴ Policy Statement, RM93-3-000, July 31, 1993.

⁵ Fox-Penner, Peter, "Electric Utility Restructuring," Public Utilities

1 Following several years of pricing disputes, the FERC In April of
2 1996 adopted Order 888 and Order 889. These Orders sought to encourage
3 wholesale competition as they were “designed to remove impediments to
4 competition in the wholesale bulk power marketplace and to bring more
5 efficient, lower cost power to the Nation’s electricity consumers.” While this
6 appears to be a commendable goal, the changes wrought by these and
7 subsequent Orders have dramatically altered the way electric utilities operate
8 in today’s electric marketplace, both wholesale and retail.

9 At the time Order 888 was adopted, California had proposed its
10 deregulation legislation which included the establishment of an Independent
11 System Operator (“ISO”) to oversee the state’s transmission system to ensure
12 that all generation suppliers had equal or comparable access to the
13 transmission grid. In fact, many commentators on Order 888 suggested that
14 some form of independent transmission entity was needed in all regions of
15 the country to ensure comparable open access to a utility’s transmission
16 service. After the adoption of Order 888 and prior to Order 2000, several
17 ISOs were established (California, PJM, New England, New York, and the
18 Midwest) in those regions where states had adopted retail competition. But
19 not every region of the country participated in the establishment of ISOs.

20 **Q. SUBSEQUENT TO THIS ORDER 888, WHAT HAS TAKEN PLACE**

1 **TO PROMOTE RTOS?**

2 **A.** On December 20, 1999, FERC issued its Order No. 2000 which
3 accelerated the initiatives begun by FERC Order 888 in that it required
4 utilities regulated by the FERC to file a plan to join or form a regional
5 transmission organization (“RTO”), or to provide an explanation as to why
6 this could not be accomplished. Order 2000 was a major step by the FERC
7 in its pursuit of open access transmission lines as it provided the FERC
8 greater regulatory controls over all electric utilities transmission business.
9 Specifically, the FERC in Order 2000, determined that “economic and
10 engineering inefficiencies and the continuing opportunity for undue
11 discrimination are impeding competitive markets...we conclude that the
12 RTOs will remedy these impediments.”⁶

13 The FERC’s approach to RTO formation was to “strongly” encourage
14 transmission owners to participate “voluntarily” and the FERC would be
15 “neutral as to organizational form of an RTO as long as it satisfies our
16 minimum characteristics and functions....” In compliance with this Order,
17 utilities had to make an RTO filing by October 15, 2000.

18 Consequently, there were new industry efforts to form additional
19 RTOs. Utilities and stakeholders actively advanced with RTO filings for the
20 Midwest RTO, the Alliance RTO and GridFlorida. RTOs in Texas, the

⁶ FERC Order 2000, December 20, 1999, p. 70/

1 Northeast, and California were already in place. As explained in the direct
2 testimony of Mr. Neville Lorick, in response to these initiatives and due to
3 the mounting pressure from the FERC to join an RTO, SCE&G and other
4 South Carolina electric utilities determined that the most desirable response
5 to these FERC initiatives was the pursuit of a Carolinas based RTO.
6

7 **III. A REVIEW OF THE DEVELOPMENT OF GRIDSOUTH**

8
9 **Q. PLEASE DISCUSS THE INITIAL REASONS FOR DEVELOPMENT**
10 **OF GRIDSOUTH.**

11 **A.** At the time, there was simply no question that due to FERC Orders
12 and mounting pressures from the FERC that the Company had to begin
13 planning the development of an RTO or begin discussions related to joining
14 an existing RTO. As related in the direct testimony of Company witness
15 Neville Lorick, SCE&G felt that an RTO covering the North Carolina-South
16 Carolina region would best suit SCE&G customers and the Company for
17 several reasons. The Company believed that the RTO would be focused in
18 its scope and, therefore, would be attuned to the customer and system needs
19 for the Carolinas. SCE&G also believed that its cooperation with Duke
20 Power and Progress Energy-Carolinas (“Progress” formerly Carolina Power

1 and Light Company) would provide a smooth transition to the functioning of
2 an RTO, since the three companies have a long and positive history of
3 operating their systems in concert. Thus, SCE&G, Duke Power and Progress
4 joined forces to create the GridSouth RTO.

5 **Q. PLEASE DISCUSS THE INITIAL DEVELOPMENT OF GRIDSOUTH**
6 **AND SCE&G'S INVOLVEMENT IN THAT PROCESS.**

7 **A.** The GridSouth RTO filing was submitted to FERC by SCE&G, Duke
8 and Progress. The Companies made their GridSouth filing on October 16,
9 2000, and FERC gave conditional approval for the RTO in March 2001.
10 Pursuant to the filing, the three utilities were to retain system expansion
11 planning for the Carolinas, native load concerns would be preserved, and the
12 Public Service Commission of South Carolina and North Carolina Public
13 Utilities Commission would retain jurisdiction over retail electric service,
14 including the transmission component.

15 In order to meet FERC deadlines, from Fall 2000 to Spring 2002 the
16 three companies worked to make GridSouth an operating entity. This work
17 was predicated on commitments from other utilities in the region to form an
18 RTO, FERC stipulated deadlines, and the general industry direction. Land
19 was procured and a facility constructed in Fort Mill, S.C. Operating systems
20 and related hardware, some staffing, software, other system supports, and the

1 related design and installation of these systems, were contracted for and
2 pursued. Throughout this process, the companies controlled costs.

3 **Q. WHY WAS DEVELOPMENT OF GRIDSOUTH ABANDONED?**

4 **A.** As discussed in the direct testimony of Company witness Lorick,
5 notwithstanding FERC's regulatory objectives under Order No. 2000 and the
6 efforts of SCE&G to meet those objectives, a change in the leadership at
7 FERC as well as Congressional pressure resulted in a dramatic change in that
8 agency's regulatory objectives. After this change, the formation of
9 GridSouth was no longer viewed as consistent with the nation's transmission
10 requirements. On June 13, 2002, the GridSouth RTO project was suspended.

11
12 **IV. THE RECOVERABILITY OF THE GRIDSOUTH**
13 **EXPENSES**
14

15 **Q. ARE THE GRIDSOUTH EXPENSES REASONABLE AND PROPER**
16 **RETAIL ELECTRIC SERVICE EXPENSES?**

17 **A.** Yes. The GridSouth expenses are reasonable and proper retail electric
18 service expenses. There is simply no question that the GridSouth partners
19 (SCE&G, Duke and CP&L) were faced with a difficult dilemma over the
20 past few years as the FERC pushed for deregulation of the electric industry.

1 Over this time period, several areas of the country and many larger customers
2 had been in favor of these changes. However, for the most part, utilities and
3 State Commissions in the Southeast and Northwest have not been in favor of
4 the FERC sponsored changes. Nevertheless, the FERC had been dogmatic in
5 its pursuit of RTOs like GridSouth, and more recently, Independent
6 Transmission Providers (“ITPs”) as described in their latest Notice of
7 Proposed Rulemaking on Standard Market Design.

8 In response to these FERC Orders, transmission owning utilities, like
9 the GridSouth partners, were required to participate in an RTO or provide
10 reasons why they could not. Moreover, the GridSouth partners were faced
11 with the unenviable choice of either developing a South Carolina and North
12 Carolina based RTO, or facing the probability of being subject to the
13 jurisdiction and rules of other RTOs that were being developed in
14 neighboring states. For example, at the same time GridSouth was being
15 developed, RTOs were being organized in Florida (GridFlorida), in the states
16 served by the Southern Company System (which became SETrans), and in
17 Louisiana, Arkansas, and Mississippi (through Entergy and others). Given
18 these other developing Southeastern RTOs, it would have been very difficult
19 for the Company and other South Carolina utilities to make a claim to the
20 FERC that they could not form or join an RTO. Furthermore, I believe that

1 the decision to pursue a South Carolina/North Carolina RTO was in the best
2 interest of this Commission and South Carolina ratepayers. Based on the
3 then-current circumstances, a Carolina based RTO would help preserve the
4 control and oversight of the state's transmission system within this region
5 and with the South and North Carolina Commissions.

6 **Q. DOES THE STAFF SUPPORT RECOVERY OF THE GRIDSOUTH**
7 **EXPENSES AT THIS TIME?**

8 **A.** Yes. Commission Staff witness Watts, in his Direct Pre-Filed
9 Testimony page 6, lines 18-24 and continuing on page 7, supports recovery
10 of the GridSouth expenses in this rate case.

11 **Q: DO YOU BELIEVE THAT THE COMPANY HAD THE OPTION OF**
12 **NOT PURSUING AN RTO, OR GRIDSOUTH IN PARTICULAR?**

13 **A.** I do not believe that the Company had any alternative other than to
14 enter into discussions related to the development of an RTO and Commission
15 Staff witness Watts appears to echo these same sentiments (Direct Testimony
16 of Staff Witness Watts, page 6, lines 18-24). The Company's decision to
17 enter the GridSouth Project was made in the spring of 2000 based principally
18 on FERC's Order 2000. In that order, FERC required all FERC jurisdictional
19 transmission owners to either join an RTO that would be functional by
20 December 15, 2001 or explain why they had not. Furthermore, as I stated

1 above, at that time every Southeastern investor owned electric utility had
2 responded to the FREC's Orders by undergoing the development of an RTO.

3 Thus it would have been very difficult for the Company and other South
4 Carolina utilities to make a claim to the FERC that they could not form or
5 join an RTO.

6 **Q: DO YOU BELIEVE THAT THE COMPANY HAD SUFFICIENT**
7 **JUSTIFICATION TO CONTINUE DEVELOPMENT OF**
8 **GRIDSOUTH OVER THE 2-3 YEARS THAT THE PROJECT WAS**
9 **BEING PURSUED?**

10 **A.** Absolutely. On October 16, 2000, the GridSouth Companies made
11 their Order 2000 compliance filing with the FERC with regard to the
12 structure and operations of GridSouth. Shortly after that, on November 3,
13 2000, the participating companies filed with the FERC for a declaratory
14 Order seeking approval of their accounting treatment related to GridSouth
15 costs. The FERC responded first to this declaratory Order request
16 affirmatively in Carolina Power and Light Co. et al. 94 FERC¶ 61,080 on
17 January 25, 2001.

18 Later, on March 14, 2001, in response to the GridSouth Order 2000
19 compliance filing, the FERC granted the GridSouth utilities provisional
20 approval for formation of the GridSouth RTO. This approval was granted in

1 the order entitled Carolina Power and Light Company et al., 94 FERC ¶
2 61,273 (the “March 14, 2001 Order”). Some of the items specifically
3 approved in that March 14, 2001 Order were as follows:

- 4
- 5 ? FERC approved GridSouth as an RTO that would operate in
- 6 only two states, though it encouraged GridSouth to broaden its
- 7 geographic scope;
- 8 ? FERC approved GridSouth as a for-profit RTO that could
- 9 eventually own the transmission assets it operates;
- 10 ? FERC approved organizational documents under which the
- 11 GridSouth utilities would manage the formation of GridSouth
- 12 with certain revisions related to the selection and approval of
- 13 the Board (note that the organizational documents indicated
- 14 that the board would be seated when GridSouth became
- 15 operational).

16

17 While this March 14, 2001 Order granted “provisional authority” to

18 implement GridSouth RTO, the provisional aspect of the order did not affect

19 the matters listed above. Instead, the provisional language of the Order

20 reflected only the fact that FERC was requiring that the original GridSouth

documents be refiled with limited changes to reflect matters decided in the Order. Therefore, the FERC response to the GridSouth application was by and large accepted by the FERC as being compliant with its initial RTO directives. Furthermore, the FERC encouraged the GridSouth partners to meet with Santee Cooper and other Southeastern utilities in an effort to expand the geographic scope of GridSouth and to report back to FERC. The GridSouth partners complied with this directive and were pursuing these issues when the FERC chairmanship changed and the FERC's overall approach relating to RTOs was altered.

Q: DOES THE COMMISSION STAFF SUPPORT YOUR CONTENTION THAT DEVELOPMENT OF GRIDSOUTH WAS IN RESPONSE TO FERC ORDERS?

A. Yes. Staff witness Watts, at page 6, lines 18-24 of his direct pre-filed testimony, states that "The project [GridSouth] was in response to directives from the FERC mandating creation of regional transmission organizations."

Q: DO YOU BELIEVE IT WAS PRUDENT TO INITIALLY SUSPEND AND NOW TERMINATE DEVELOPMENT OF GRIDSOUTH?

A. Yes. During the summer of 2001, there was a leadership change at FERC and what I would characterize as a more aggressive FERC policy toward RTOs emerged. For example, on July 12, 2001, FERC issued two

1 orders. The first, Regional Transmission Organizations, Order Initiating
2 Mediation, 96 FERC ¶ 61,066 (2001), opened with the following language:

3 *“In separate orders to be issued concurrently with this order,*
4 *the Commission concludes that it is necessary that the Southeastern*
5 *transmission owners combine to form one Regional Transmission*
6 *Organization (RTO). In this order, the Commission initiates mediation*
7 *for the purpose of facilitating the formation of a single RTO for the*
8 *Southeastern United States.”*
9

10 In issuing this order, FERC signaled that a) a two-state Southeastern RTO
11 was no longer acceptable, and b) that FERC’s earlier decisions approving the
12 structure and governance of GridSouth were now subject to reversal in the
13 mediation process by which a single Southeastern RTO would be formed. As
14 an indication that the FERC’s policies towards RTOs had changed, a quote
15 from Commissioner Massey’s concurring opinion in that July 12, 2001 Order
16 is revealing:

17 *“Today marks a watershed in the evolution of our RTO policy. For*
18 *the first time we set a clear objective for RTO topography, meaning*
19 *geographic scope, and indicate a fresh resolve to get the RTO job*
20 *done.....the Commission adopts as its firm objective a single RTO for*
21 *the Northeast, one for the Southeast, one for the Midwest, and one for*
22 *the West.....With this clear objective, we at long last provide much*
23 *needed guidance to the industry.....This guidance is long*
24 *overdue...But better late than never.”*
25

26 There was simply no question in FERC Commissioner Massey’s mind, and in
27 the minds of most knowledgeable industry observers, that the FERC’s RTO

1 policy had changed with this Order.

2 **Q: PLEASE DISCUSS THE IMPACT OF THE SECOND FERC ORDER**
3 **YOU MENTIONED ABOVE.**

4 **A.** In the second Order issued on the same day (July 12, 2001, Carolina
5 Power and Light Co. et al, 96 FERC ¶ 61,067) FERC reiterated that it would
6 not permit an RTO of less than regional scope. The FERC also went further
7 and reversed several specific approvals granted in the March 14, 2001 Order:

8 ? FERC reversed its earlier approval of the organizational
9 documents under which the GridSouth Board would be seated
10 only when the GridSouth RTO became operational. Instead,
11 FERC required the GridSouth Board to be seated within 90
12 days and all decisions going forward to be made by that
13 Board.

14 ? FERC reversed its earlier approval of the plan under which the
15 GridSouth utilities would choose the initial officers and
16 managers of GridSouth.

17 ? FERC ordered one officer, already chosen pursuant to the
18 earlier documents approved by FERC, to be removed from
19 office.

1 In her dissenting opinion to that Order, Commissioner Breathitt stated the
2 following:

3 *“Today's order represents a dramatic departure from the approach*
4 *we pursued in Order No. 2000 to the extent that it directs the*
5 *formation of four specific RTOs. Just as some commenters to our*
6 *RTO rulemaking feared, the Magic Markers have come out, and the*
7 *boundaries are being drawn with little regard to the status and*
8 *timing of RTO formation efforts in various regions of the country.*
9 *This was not my intent at the time we issued Order No. 2000; and the*
10 *events since we issued Order No. 2000 do not compel me to embrace*
11 *this policy shift. Parties have spent many hours and countless*
12 *resources in negotiations, collaborations, and complicated business*
13 *strategy sessions to develop reasonable RTO approaches. The*
14 *impact of the majority's directive that these four RTOs be formed*
15 *could be to render these efforts useless and force parties to begin the*
16 *difficult and time-consuming process anew.”*
17

18 In this second FERC Order issued on July 12, 2001, Commissioner
19 Breathitt clearly indicates that the FERC's policy towards RTOs had
20 changed. Given this change in FERC policy, along with the impending
21 issuance of a Standard Market Design, the GridSouth partners were prudent
22 in reevaluating the wisdom of proceeding with their initial RTO plans. In
23 addition, the Congress is considering the possible adoption of a national
24 energy bill that would likely impact both the FERC's transmission
25 jurisdiction and transmission policy. Until the regulatory future becomes
26 more certain, the structure, operational requirements, and responsibilities of
27 RTOs, particularly one like GridSouth, is virtually unknowable.

1 **Q. SOME INTERVENORS HAVE SUGGESTED THAT PURSUING THE**
2 **GRIDSOUTH RTO CONCEPT WAS FLAWED BECAUSE THE**
3 **FERC HAD INDICATED A PREFERENCE FOR A SINGLE**
4 **SOUTHEASTERN RTO. DO YOU AGREE WITH THIS**
5 **ASSESSMENT?**

6 **A.** No, I strongly disagree simply because this does not reflect the
7 circumstances at the time. While I admit the FERC encouraged a single
8 Southeastern RTO, the simple fact is that there were a number of RTOs
9 throughout the country that reflected a less than fully regional scope (New
10 England, Midwest, Alliance, GridFlorida, SETrans, Entergy, SPP). In fact,
11 even today there is no consensus within the industry supporting just four
12 large regional RTOs. More importantly, FERC, in fact, approved the
13 geographic configuration of GridSouth before it changed regulatory direction
14 in the Summer of 2001.

15 **Q: IN YOUR OPINION, WAS THE DECISION TO ENTER THE**
16 **GRIDSOUTH PROJECT REASONABLE AND PRUDENT?**

17 **A.** In my opinion, the decision to enter the GridSouth project was
18 reasonable and prudent. GridSouth represented a unique opportunity to
19 create a locally based RTO answerable to the customers and regulators of
20 South and North Carolina that at the time complied with the FERC's RTO

1 requirements.

2 **Q. PLEASE EXPLAIN MORE FULLY WHY YOU AGREE WITH**
3 **STAFF WITNESS WATTS,(DIRECT TESTIMONY, PAGES 6-7),**
4 **THAT THE EXPENSES FOR GRIDSOUTH SHOULD BE**
5 **RECOVERED IN THIS CASE?**

6 **A.** The GridSouth project was begun for good reason and likewise, has
7 been terminated for good reason. SCE&G's participation in GridSouth was
8 simply a required response to FERC Orders and in doing so, an effort to
9 maintain local control in, and a local presence for, the State's electric
10 transmission grid. Also, it is no secret that the formation of an RTO in the
11 Southeast had been and remains a prime objective of the FERC. Given these
12 circumstances, SCE&G's actions to implement and ultimately to suspend the
13 GridSouth initiative were prudent. Moreover, there will not be any future use
14 for the system and the related costs already incurred. All the assets of
15 GridSouth have been disposed of and there will be no future utilization of
16 these assets for transmission, or any other purposes.

17 In summary, SCE&G's decision to participate in the development of
18 GridSouth was prudent and the costs expended should be fully recoverable at
19 this time. The Commission previously addressed the recovery of GridSouth
20 costs in Docket 2002-223-E, Order No. 2003-38. In this Order the

Commission concluded that “it is premature to allow the recovery of GridSouth costs at the retail level at this time” (p. 17) due to the fact that the future utilization of GridSouth assets was uncertain. This is no longer the case.

Q. DO YOU AGREE WITH SOME INTERVENORS (SMITH, DIRECT TESTIMONY PAGE 6, LINES 1-4; O’DONNEL, PAGE 19, LINES 1-3) THAT THESE EXPENSES SHOULD NOT BE RECOVERED BECAUSE THEY ARE NOT USED AND USEFUL IN PROVIDING ELECTRIC SERVICE?

A. I disagree. These expenses were incurred specifically in response to regulatory Orders and directives. Regulated utilities must respond to and remain in compliance with the directives of the regulators with jurisdiction over them. Costs incurred to do so are a necessary part of utility operations and are used and useful in providing electric service.

Q. CAN YOU GIVE SOME EXAMPLES OF THE TYPES OF EXPENDITURES ELECTRIC UTILITIES MUST UNDERTAKE IN RESPONSE TO REGULATORY DIRECTIVES THAT SOME MAY CONSIDER AS NOT DIRECTLY RELATED TO THE ACTUAL PROVISION OF ELECTRIC SERVICE?

A. Yes. The Company routinely incurs costs in responding to regulatory

1 directives from federal regulators, such as hydro relicensing requirements
2 imposed under the Federal Water Power Act, nuclear operating requirements
3 imposed on the V.C. Summer Nuclear Plant based on new or revised
4 directives from the NRC, and accounting and other directives imposed on it
5 by the SEC. These and other costs incurred to meet the valid directives of
6 Federal or State regulators are valid expenses related to the provision of
7 electric service, just as are costs imposed by the South Carolina Department
8 of Health and Environmental Control (“DHEC”). As such, these costs are a
9 necessary element in the overall costs related to the provision of electric
10 service.

11 **Q. DO YOU AGREE WITH MR. SMITH, (DIRECT TESTIMONY, PAGE**
12 **6, LINES 7-22) AND MR. O’DONNEL, (DIRECT TESTIMONY, PAGE**
13 **19, LINES 17-21) THAT THESE EXPENSES SHOULD NOT BE**
14 **RECOVERED BECAUSE THEY ARE EXPENSES PRIMARILY**
15 **RELATED TO THE WHOLESALE MARKET AND THEREFORE**
16 **SHOULD NOT BE RECOVERED FROM RETAIL RATEPAYERS?**

17 **A.** I disagree. As designed, GridSouth would manage the scheduling of
18 generation and transmission resources, transmission planning for the
19 integrated grid, and critical real-time grid security functions to benefit both
20 retail load serving entities, like SCE&G, as well as wholesale customers.

1 Furthermore, the operations of the transmission grid and the transmission
2 tariffs under RTOs would involve the provision of various services, including
3 ancillary services, that would be for the benefit of all customers, wholesale
4 and retail.

5 The investment in the transmission related functions that GridSouth
6 represents has been treated by the Company in precisely the same way it has
7 treated other transmission related investments made to serve its system. The
8 GridSouth costs have been allocated to retail and wholesale service in
9 proportion to the use of transmission assets by each of the two classes of
10 service. This allocation is in keeping with standard and well-accepted
11 regulatory practice. Given these facts, it is reasonable to recover the costs for
12 GridSouth from all ratepayers as the Company proposes.

13 **Q. MR. SMITH, (DIRECT TESTIMONY, PAGE 5, LINES 9-15) ARGUES**
14 **THAT THE GRIDSOUTH EXPENSES SHOULD NOT BE**
15 **RECOVERED BECAUSE THEY “DO NOT RISE TO A LEVEL OF**
16 **MATERIALITY.” DO YOU AGREE?**

17 **A.** I disagree. While \$14 plus million dollars may not seem significant to
18 Mr. Smith or his client, the Department of the Navy, this \$14 plus million is
19 significant to this Company. Intervenors often spend countless hours in rate
20 cases in attempts to find disallowances far less than this amount – and I

1 would have to assume that these intervenors believed those disallowances,
2 often well below six figures and much less than this expense, were
3 significant to their customers and/or the Company.

4 **Q. DO YOU AGREE WITH MR. WATKINS THAT GRIDSOUTH IS**
5 **SIMPLY “A FAILED BUSINESS VENTURE,” (DIRECT**
6 **TESTIMONY, PAGE 63, LINES 9-10), AND THAT**
7 **SHAREHOLDERS, NOT RATEPAYERS, SHOULD BE**
8 **RESPONSIBLE FOR THESE COSTS?**

9 **A.** I disagree. The GridSouth project was clearly a response to a FERC
10 Order and the expenses incurred should be fully recoverable. To illustrate
11 what a failed business venture might be, consider the regulated electric
12 utilities that undertook significant competitive wholesale generation
13 development – like the now bankrupt Mirant, an unregulated subsidiary of
14 the Southern Company. Mirant is an example of a failed business venture,
15 undertaken by a utility as a competitive, unregulated venture, and in no way a
16 response to any regulatory order.

17 **Q. CAN YOU PROVIDE THIS COMMISSION WITH EXAMPLES OF**
18 **UTILITY INVESTMENTS WHERE THE ASSETS WERE NO**
19 **LONGER BEING USED TO PROVIDE SERVICE OR WHERE THE**
20 **PROJECT WAS TERMINATED PRIOR TO COMPLETION AND**

1 **DESCRIBE HOW THESE COSTS WERE RECOVERED?**

2 **A.** Yes. One example would be copper wire that was replaced by fiber
3 optics. Another would be analog telephone equipment that was replaced by
4 digital equipment. In both situations the telephone industry was faced with
5 the dilemma of how to replace existing technology whose cost was still being
6 recovered with newer, more modern technology. In North Carolina, we
7 encouraged the move to these newer technologies by allowing the utilities to
8 accelerate the recovery of the costs of the older, and soon to be, unused
9 equipment.

10 Another example would be the recovery of cost related to abandoned
11 nuclear plants. In the late 1970s and early 1980s, this and other commissions
12 were faced with cancellations of partially constructed nuclear plants. In
13 these situations, the plants' construction had begun some years earlier with
14 commission approvals and justification based on load growth and cost
15 projections. Some years later, these abandoned nuclear plants were deemed
16 unnneeded and/or cost prohibitive, and construction halted. In most cases, the
17 costs incurred by the utilities were recovered with some stipulations usually
18 related to the cost recovery time period and whether the utility could recover
19 all or part of its cost of capital. In the case of Duke Power Company's
20 abandoned nuclear plants, in both South and North Carolina the commissions

1 allowed Duke Power the opportunity to recover its abandoned nuclear plant
2 costs but did not allow a rate base treatment of the costs. (See South
3 Carolina Orders No. 83-92 and 84-108, North Carolina Order No. E-7, SUB
4 358.)

5 **Q. DO YOU BELIEVE THAT THIS CASE IS THE PROPER TIME TO**
6 **RECOVER THESE COSTS?**

7 **A.** Yes. The Company has incurred these expenses and, as I have already
8 discussed, deserves the recovery of these costs. Moreover, the Company has
9 developed information in this proceeding that fully supports the recovery of
10 these costs by proving the following:

11 ? The GridSouth expenditures were made in a prudent effort to comply with
12 regulatory orders;

13 ? The GridSouth project was approved by FERC;

14 ? The GridSouth project was prudently managed and the Commission Staff
15 has audited the resulting expenditures;

16 ? The abandonment of GridSouth was appropriate in light of dramatic and
17 unanticipated policy changes at FERC;

18 ? All GridSouth assets have been disposed of and there is nothing held for
19 possible future use.

20 Given these facts, I believe it is proper that the Commission approve the

1 recovery of the GridSouth costs in this proceeding.

2 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

3 **A.** Yes.